

**Before the
Federal Communications Commission
Washington, D.C. 20554**

In the Matter of)	
)	
The Effect of Foreign Mobile Termination)	
Rates On U.S. Customers)	IB Docket No. 04-398

Telefónica S.A. comments on Notice of Inquiry

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COMMENTS TO THE NOTICE OF INQUIRY ON THE EFFECTS OF FOREIGN MOBILE TERMINATION RATES ON U.S. CUSTOMERS (IB Docket No. 04-398)

INTRODUCTION

Telefónica would like to take the opportunity to provide its comments to the FCC Notice of Inquiry (NOI) on the effects of foreign termination rates on U.S. customers, issued on October 26, 2004, as this company already provided its views on the ISP Reform proceeding in 2002¹.

Telefónica wishes to underscore some of the aspects already indicated in its previous comments. Due to the relevance of these comments, they should be kept in mind (part 1) before raising some specific points related to the FCC NOI (part 2).

COMMENTS

In order to assess the impact of foreign mobile termination rates on U.S. customers, it is essential that the following aspects be considered:

I - General aspects

1. International jurisdiction.

- WTO Role in the global Telecommunications market

This consultation extends beyond the territory of the US to touch upon issues related to the global telecommunications market, regulated within the WTO by the GATS agreement, its Annex on Telecommunications and the Reference Paper on Basic Telecommunications Services.

If any conflict in the provision of telecommunications services arises between WTO Member States they must seek the best possible solution within the WTO-GATS framework. Since the USA is a Member State of the WTO, the FCC, rather than adopting unilateral actions with extraterritorial reach, should rely upon the WTO dispute settlement procedure to resolve any conflict in the provision of telecommunications services that involves other WTO Member States.

¹ Notice of Proposed Rulemaking 02-285 in the matter of International Settlements Policy Reform and International Settlement Rates released on October 2002

- Non-Discrimination amongst WTO Member States

As stated in the preamble of the agreement, one of the objectives that inspired the negotiation of the GATS, of which the USA was a clear proponent, was the "establishment of a multilateral framework for principles and laws directed at the progressive opening of the services industry to facilitate the expansion of this trade and contribute to the economic development of the entire world". Among these principles those of the Most Favoured Nation Treatment (MFNT) and National Treatment (NT) have been crucial to guarantee that same terms and conditions apply to service providers under non-discriminatory terms in international commerce². The acceptance and application of a non-discriminatory treatment is therefore compulsory for operators in a WTO Member State where GATS commitments have been adopted. The U.S. Government should recognise that the commercial practices currently in effect under these principles are contributing to world economic growth while complying with economic policies and the free market of each Member State in its entirety. In short, a decision that could affect this multilateral framework of economic growth should not be based solely on cost savings for its own consumers, reduction of costs for North American carriers and stability in the USA's balance of payments.

In the specific case of foreign mobile termination rates, the application of the MFN and NT principles and their supervision by national regulatory authorities prevent the existence of different prices for termination services depending on the interconnected operator or the country of origin.

Moreover, in the EU, the price that carriers transporting international calls must pay, no matter what the origin of the call, is exactly the same as for other operators either national or international. This model is a result of the application of the non-discriminatory obligations. From this perspective, it is not possible to imagine a differentiated price for terminating calls originated in the US.

Likewise and still based on the non discrimination principle, positive discrimination in favour of US consumers by charging a lower tariff than to other consumers cannot be contemplated either. This hypothetical case could lead or facilitate practices involving the so-called "refilling" phenomenon, i.e. routing the traffic destined to non-US mobile operators through US international carriers benefiting from these special advantages.

More specifically, in the European regulatory framework, this principle is also present for the benefit of every user, but also to avoid distortions in a given market. So it is the first remedy and obligation imposed to an SMP operator where there is a failure detected in a specific market. In the mobile termination market, this obligation is also applied; therefore

² GATS Article II, on most-favoured-nation treatment states that "with respect to any measure covered by this Agreement each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than it accords to like services and service suppliers of any other country".

GATS article XVI in relation with the sector specific commitments adopted by WTO Member States in their schedules, states that "in the sectors covered by its schedule, and subject to any conditions and qualifications set out in the schedule, each member shall give treatment to foreign services and service suppliers treatment, in measures affecting supply of services, no less favourable than it gives to its own services and suppliers".

mobile operators cannot discriminate on their termination prices towards other operators. Of course, US carriers are also included in this operator's category. Consequently it is clear that there is no possibility that European Mobile operators can discriminate US operators as it contravenes to the rules they have to comply with.

- **Existence of specific national regulatory frameworks worldwide**

The FCC cannot intervene in other national markets. These markets have a specific national regulatory framework that guarantees its control and supervision in order to detect any problem and to come up with the most adequate remedy.

As an example, in Europe there is also a specific regulatory framework for supervising the Electronic communications market. The European Union has adopted a new regulatory package in 2002 for the electronic communications market whose objective is to foster competition for the users' benefit, while ensuring a consistent application of this new framework in every Member State. This new package was required to be implemented in every Member State by July 2003, thus giving a relevant role to every NRA to follow and monitor their national electronic communications market. This new framework leaves each NRA present in every Member State the freedom to decide which are the most appropriate measures for a specific national market situation, following a well-established procedure, based on a strict market analysis methodology. Furthermore, in some countries such as Argentina or Chile, mobile termination tariffs are decided directly by the National Regulatory Authority. Mobile operators are not able to alter or modify them.

Governments are free to choose whatever termination model they consider most suitable to internal market development and competition enhancement. Only national policy can grant the authority to supervise national termination rates. Consequently, National Regulatory Authorities are ultimately in charge of supervising conditions for call termination by mobile operators, guaranteeing that they comply with the principles of transparency and non-discrimination. Should these principles and conditions not be effectively enforced and a market failure detected, National Regulatory Authorities can impose corrective measures taking into consideration national market conditions and characteristics and adapting such imposed measures to the problem detected. All these measures guarantee a real and effective control on mobile termination tariffs in these countries, and mostly in all CPP markets. Moreover, in some cases, mobile termination tariffs are directly imposed by the NRAs. Both controls limit the mobile operators' decision-making abilities. Precluding the independence of mobile operators behaviour is the basic premise for the existence of abuses of dominant positions. Any abuse would then be subject to an ex-post control by the NCAs, in accordance with sectorial regulation and Competition Law. This would result in its immediate correction so that the mobile operator causing the abuse would be required to cease the action. The acceptance of the existence of mobile termination tariffs that do not comply with these regulatory obligations calls into question the NRAs' jurisdiction and would mean that these authorities acknowledge behaviour that is prejudicial to national customers and not only to international ones. Consequently, the FCC has no jurisdiction to undertake unilateral actions regarding national regulatory policy and, in particular, in relation to foreign termination rates.

The European Commission has issued guidelines on the analysis of electronic communication markets and is working on defining the selection of the appropriate remedies designed to solve any problems that might arise, co-operating with every NRA.

The European Commission has also drawn up a list of markets that should be analysed. One of these markets is the mobile termination market. So every NRA has the duty to study and monitor this particular market, as it comes under its particular jurisdiction.

If a market failure is detected, NRA must evaluate who are the operators that have a significant market power on this market and could impose, if necessary and if competition rules cannot solve the problem the appropriate remedies, taking into account that these measures are adequate to the market failure identified, that they are proportionate to the problem detected and limited on time to the strict minimum necessary. This process involves also operators present in this market but also other NRAs and the European Commission in order to assure a correct interpretation of the new European regulatory framework.

This specific regulatory framework is being implemented within the EU, therefore concerning mobile termination, FCC cannot intervene in this process as there are already competent bodies with the adequate information on these markets that are analysing these questions and the possible problems in order to adopt the most adequate solution for the market characteristics.

- ***Dynamism of the mobile communications market and increase in competition***

Telefónica would like to emphasize that the mobile market is very competitive, since mobile services were born under competitive conditions. Despite the short existence of the mobile market, the results achieved have been very positive, increasing the quality and number of services provided but also resulting in an accessible level of prices for consumers.

These trends are clearly indicated in the conclusions of the last European Comision report published the 02/12/2004³, underlining that, in general *“The e-communications services sector is characterised by an increasingly positive outlook. Competition is intensifying in most markets, bringing increased benefits in terms of price, quality and innovative services to consumers.”*

Therefore, this increase in competition levels has a clear effect on the general level of prices as there are more competitors, hence more market pressure. At the same time, there is also the creation of economies of scale and more efficiency from operators to eliminate those costs that are not strictly necessary, in order to become more competitive. Mobile operators have not been left out of this competitive pressure and, consequently, their prices have also been decreasing in recent years.

Concerning the mobile market, the 10 th EC Report already mentioned indicates that: *“A few general trends suggest that competition in aspects of the mobile sector is increasing. The average market share of leading operators has dropped from 46.6% last year to*

³ The report can be consulted at :

http://europa.eu.int/information_society/topics/ecomm/all_about/implementation_enforcement/annualreports/10threport/index_en.htm

43.2% this year, a fall greater than that seen in the last three years combined.” (p.4). These data clearly indicates the increase level of competition and therefore the decrease trends of prices in Europe.

- **Decrease of mobile termination rates**

Mobile termination rates have decreased over time since mobile services were born under competitive conditions, market pressure has pushed down termination rates.

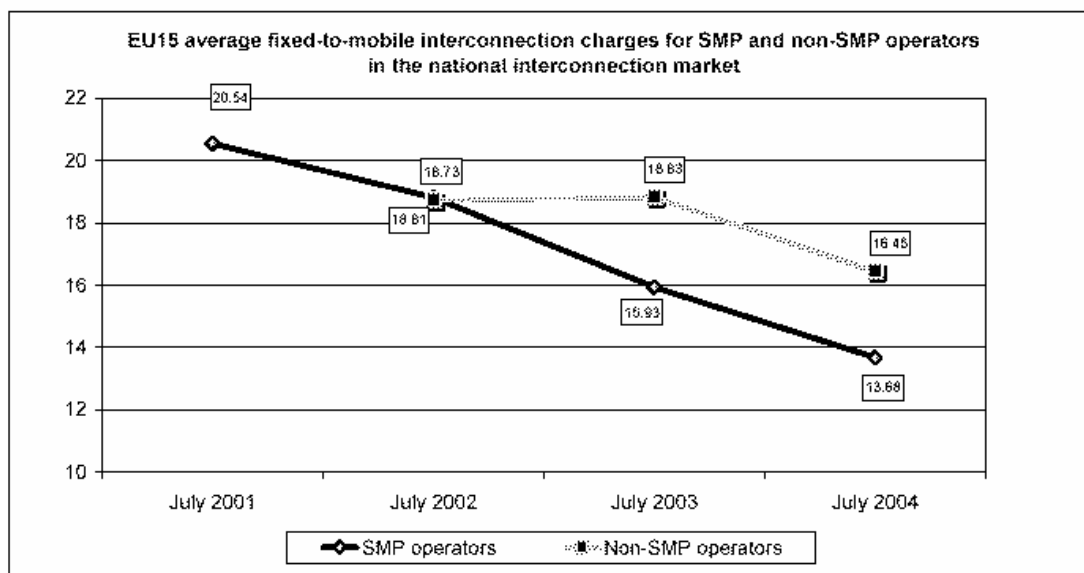
In that way, the 10th Report also mentions that:

“...there has been a welcome reduction in mobile termination rates in many EU countries during the year, although further reductions will undoubtedly follow from intervention by NRAs” (page 4)

Moreover, national regulatory authorities have used their powers to analyse this particular market and impose a decrease of mobile termination tariffs, where it was necessary, but taking into account national market specificities and applying the principles of proportionality, appropriateness, assuring a sustainable competition in the mobile market, as it is underlined in the 10th EC Report:

“In response to regulatory intervention, there has been a welcome downward trend in these rates over the last year. The average fixed-to-mobile termination rate for SMP operators in the EU 15 fell by 14% between July 2003 and July 2004 (p.9).”

As we could appreciate in the following chart published in the 10th EC Report, the trends concerning the EU average fixed-to-mobile interconnection charges have been constantly decreasing for SMP operators as for non-SMP operators in Europe. It is realistic to think that these trends will continue in the following years, due to competition and European NRAs intervention in those markets where a failure is detected.



Source: Commission services based on NRA data

Chart Published in the EC 10th Report, 02/12/04.

As a conclusion and after the data brought in this paper, Telefónica again wishes to underline that the FCC cannot act on mobile termination rates, as currently there are specific actions taken at the National level, and therefore a possible FCC act could only have a negative impact on the National balanced regulatory framework and its execution.

2. RPP vs. CPP

As Telefónica clearly indicated in its 2002 contribution, it is essential to bear in mind that every country has the complete freedom to choose the system they wish to apply for a proper development of their telecommunications market.

RPP (Receiving Party Pays) and CPP (Calling Party Pays) are just two different termination models. Each model has its own particularities and every country has been free to chose between them. This choice has significantly influenced the development of the national telecommunications market through the mobile sector. Thus, economic data clearly indicates that those countries that opted for CPP have achieved major benefits for their societies at a faster pace.

Specially remarkable are the following differences between both models:

- Relationship between mobile penetration and mobile termination model

Countries under the CPP model exhibit higher levels of penetration than countries under the RPP level. On the one hand, and under the RPP model, mobile users cannot control their telecommunication costs. User's fees not only depend on calls made by the customer but on incoming calls. Therefore, the RPP model raises greater difficulties for low consumption segments and segments with low income levels. On the other hand, the CPP model allows users to fully control their expenses. Consequently, this market is open to all users and has allowed a

successful implementation of the prepayment method, especially suited to low income and consumption segments.

- *Nature of the termination service*

The distinction between models also affects the nature of the call termination service. While under the RPP model, call termination is conceived as a service offered by the destination operator to the final user receiving the call, under CPP, call termination is a service offered by the destination operator to the operator originating the call. Thus, with the CPP system, the relationship is limited to network operators, preventing the outcome of this relationship from being extended to the service provision conditions offered to the end user.

- *Differences between RPP and CPP termination rates*

The disparities between both models account for the differences in mobile termination rates. The CPP mobile termination rates are higher than RPP mobile termination rates. Nevertheless, the fact that these mobile termination tariffs are higher does not mean, in any way, that they are not fully justified. Termination rates correspond to the business model of mobile operators as established under national regulation and are continuously being monitored by the national regulatory authorities.

II – Specific aspects

Telefónica considers necessary to provide specific comments on some particular aspects raised in the FCC paper.

1. There is no clear analysis of the current U.S. market situation

In its paper, the FCC seems to focus on the situation of the foreign mobile market instead of trying, initially, to carefully analyse the current situation of the US market and any possible failures.

The FCC appears to be worried about the impact of foreign termination rates on their customers. However, a more careful look at the American market shows that there is no such impact. What's more, faults in its own market are preventing the translation in foreign termination rates of reductions to North American customers.

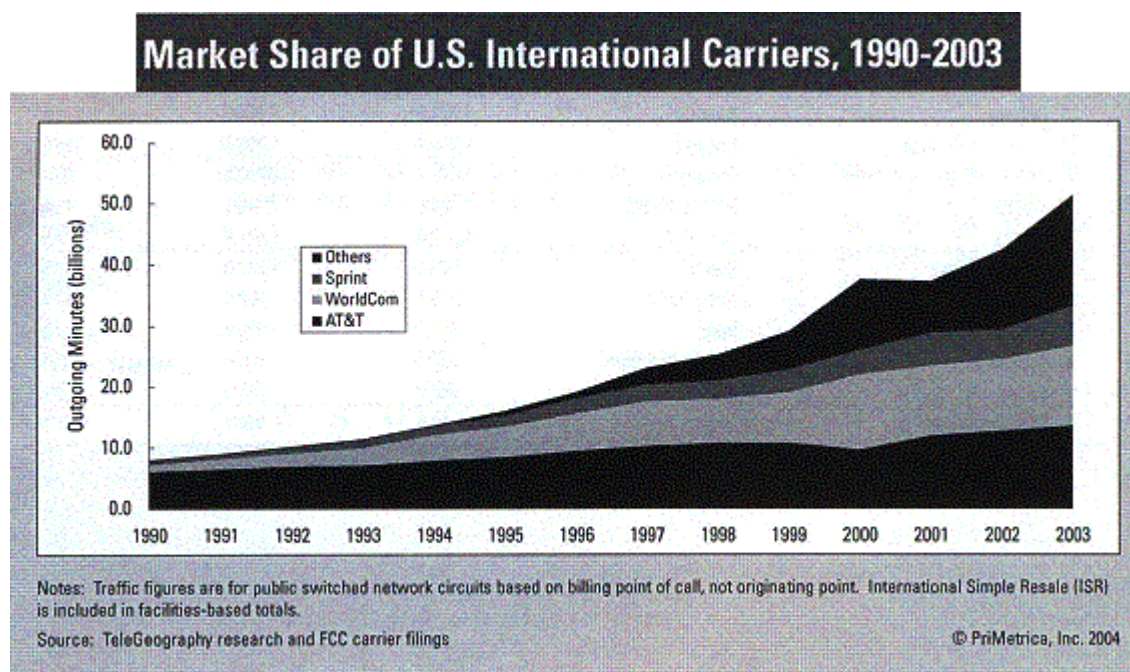
The FCC attributes the prices paid by its consumers to foreign termination rates. Nevertheless and as Telefónica already explained in its comments to the last FCC NPRM on foreign termination rates⁴, the FCC indicated that, during the period 1997 to 2001, international accounting rates have decreased from \$0.35 to \$0.14 while the average retail prices for outgoing US international calls have decreased from \$0.67 to \$0.33. Using these figures (provided by the FCC), it can be stated that the margin for international carriers (difference between average retail price and international accounting rate, not including other operational costs) has significantly increased from 48% to 58% over the same period of time. These surprising figures may lead us to consider that rate reductions has not been

⁴ NPRM 02-285

totally passed on to the US end consumer but used by the main US international carriers to significantly increase their profits.

The information provided in the TeleGeography 2005 report supports this statement: the settlement rates paid to foreign countries by the three major US carriers (AT&T, Worldcom and Sprint) have decreased from \$0.37 to \$0.10. However, *“The comparison of fixed and mobile retail rates suggests that carriers are now recovering their high costs of mobile termination... and then some....while the average wholesale carrier markup for calls to mobiles is \$0.12 per minute higher than calls to fixed, the retail markup is \$0.27... For many carriers, it would seem that high mobile termination fees offer a useful excuse to stem the price decline trend.”*⁵

As shown in the chart below, during the same period (1997 to 2003), international US outbound traffic has increased considerably. Since the long-distance international market is a business involving economies of scale, under conditions of effective competition, any increase in traffic should reduce the average costs per minute that the US carrier has to bear for carrying a call from the originating point to the interconnection point through the international carrier. In addition, the costs related to capacity leasing have decreased annually by 50%. However, the income retained by the large carriers has remained practically constant. Therefore and as the following diagrams show, there are indications that US carriers have not passed on these cost savings to their customers.



The previous figures and facts show that it should be necessary a deeper analysis by the FCC of the U.S. carriers' price structures, as the latter should align their prices to the costs of this type of calls. This does not seem to be the case in this particular issue. Moreover, it does not indicate whether U.S. carriers are translating the decrease of mobile termination charges abroad in their own prices. The FCC seems to assume that these prices are too high but it is not looking carefully at the reasons for these price levels, by not analysing U.S. carriers actions, considering the tariffs movements for their decrease abroad.

⁵ TeleGeography Research, "TeleGeography 2005", November 2004.

Another relevant issue not mentioned in the FCC paper is the level of transparency brought by U.S. carriers to their users in order to inform them of the current tariff model for foreign mobile calls. U.S. carriers should ensure that the users are precisely and well-informed of the tariffs they charge for the services they offer. However, the FCC does not seem to have studied this important point, as nothing is mentioned in its paper. But price transparency is an essential issue in a competitive market and strives to increase U.S. users' protection.

2. Looking for the benefit of North American users

The goal of regulatory actions is to foster competition for the benefit of end users and consumers. In this case, FCC's actions protect North American operators more than international end users or even North American customers. As previously discussed, North American operators have not passed rate reductions on to end consumers. Moreover, unilateral actions by the FCC will hurt competition in the international arena in favour of a limited number of players in a specific country. This action seems to be against the international interests in the global electronic communications market.

Moreover, if we carefully read the FCC paper, there is no explicit or reiterative complaints by North American users regarding foreign termination rates. Therefore, we ask ourselves whether termination rates do pose a real problem for North American users and whether FCC intervention is really required.

In the words of the FCC⁶, U.S. international telecommunications carriers apply mobile surcharges to residential customers when calling to 161 countries. Telefónica wonders about the reasons for these charges and urges the Commission to open an investigation into these added fees.

Finally, it is essential to indicate that, in a global market, rules cannot be applied in an asymmetric way to guarantee the balance of different market situations. For this reason, it is quite surprising that the FCC seems to be asking for cost orientation from foreign mobile operators in order to decrease mobile prices. However this NRA does not wish to impose a similar obligation on their carriers, in order to benefit U.S. users. Therefore, Telefónica wonders what the final objective of the FCC is and would not like to think that the main goal of this consultation is to solely protect the interests of U.S. carriers instead of U.S. consumers.

As a conclusion and in order to guarantee user benefits, a proper analysis of the U.S. market must occur. Such an analysis will detect market failures and increase users' information about these foreign mobile terminated calls. Finally, Telefónica would like to point out that there are no existing barriers able to block direct interconnection between U.S. carriers and mobile operators. Such interconnection will decrease the number of mediators, thus reducing the charges passed on to U.S. consumers.

⁶ FCC 04-247